

No. 12609

**In the United States Court of Appeals
for the Ninth Circuit**

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SIGVALD NIELSON AND MADGE NIELSON, RESPONDENTS

*ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX
COURT OF THE UNITED STATES*

BRIEF FOR THE PETITIONER

THERON LAMAR CAUDLE,

Assistant Attorney General.

ELLIS N. SLACK,

HARBY MARSELLI,

Special Assistants to the Attorney General.

FILED

NOV 30 1950

PAUL P. O'BRIEN,

CLERK

INDEX

	Page
Opinion below.....	1
Jurisdiction.....	1
Question presented.....	3
Statute and Regulations involved.....	3
Statement.....	4
Statement of points to be urged.....	8
Argument.....	9
Conclusion.....	10

CITATIONS

Cases:	
<i>Commissioner v. Enersen</i> , No. 12610.....	9
<i>Marshall v. Commissioner</i> , 14 T. C. 90.....	9
Statutes:	
Internal Revenue Code, Sec. 107 (26 U. S. C. 1946 ed., Sec. 107).....	3
Revenue Act of 1943, c. 93, 58 Stat. 21, Sec. 119.....	4
Miscellaneous:	
Treasury Regulations 111, Sec. 29.107-1.....	4

(I)

In the United States Court of Appeals for the Ninth Circuit

No. 12609

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SIGVALD NIELSON AND MADGE NIELSON, RESPONDENTS

*ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX
COURT OF THE UNITED STATES*

BRIEF FOR THE PETITIONER

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 48-55) are not officially reported.

JURISDICTION

These petitions for review (R. 57-60, 62-65) involve proceedings with respect to deficiencies in income tax determined by the Commissioner against Sigvald Nielson (hereinafter referred to as the taxpayer) for the year 1944 in the amount of \$405.74 (R. 11-16) and against his wife, Madge Nielson, for the same year in the amount of \$450.45 (R. 20, 48). The taxpayer and his wife are individuals residing in Palo Alto, California, and they filed their respective federal income tax returns for the year 1944 with the Collector of Internal Revenue for the First District of California. (R. 20, 49.) By letters dated

November 18, 1948 (R. 11-16), the Commissioner of Internal Revenue notified the taxpayer and his wife, respectively, that the determination of their income tax liability for the year 1944 disclosed deficiencies in the amounts above stated.¹ Within 90 days thereafter, namely, on December 3, 1948, the taxpayer (R. 2) and his wife (R. 4), respectively, filed with the Tax Court petitions (R. 6-16 and see Fn. 1, *infra*) for a redetermination of the deficiencies determined by the Commissioner as above stated, pursuant to Section 272 of the Internal Revenue Code. On January 27, 1950, the Tax Court entered its decisions (R. 55, 56) finding no deficiencies for 1944 as to the taxpayer and his wife, respectively (and, further, finding overpayments, as hereinafter explained). Less than three months thereafter, namely, on April 21, 1950 (R. 3, 5), the Commissioner filed his petitions (R. 57-60, 62-65) for a review by this Court of the decisions of the Tax Court, pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

¹ The printed record in this Court contains only a copy of the deficiency letter addressed to the taxpayer (R. 11-16), which was attached as Exhibit A to his petition to the Tax Court (Docket No. 21103, R. 6-10). The letter addressed to the wife, which was attached as Exhibit A to her petition to the Tax Court (Docket No. 21104), as well as her petition and the Commissioner's answer, and also the copy of her income tax return for 1944, have been omitted from the printed record by stipulation of the parties, in which it was agreed (R. 76) that, except for immaterial minor differences, they are identical to the corresponding documents in the case of the taxpayer.

QUESTION PRESENTED

The question presented is whether an incoming partner may avail himself of Section 107 (a) of the Internal Revenue Code with respect to his share of a fee received by a partnership for services performed over a period exceeding 36 months, if he has not been a member of the partnership for 36 months or more at the time of its receipt.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 107 [as added by Section 220 of the Revenue Act of 1939, c. 247, 53 Stat. 862, and amended by Section 139 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. COMPENSATION FOR SERVICES RENDERED FOR A PERIOD OF THIRTY-SIX MONTHS OR MORE.

(a) Personal Services.—If at least 80 per centum of the total compensation for personal services covering a period of thirty-six calendar months or more (from the beginning to the completion of such services) is received or accrued in one taxable year by an individual or a partnership, the tax attributable to any part thereof which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had it been included in the gross income of such individual ratably over that part of the period which precedes the date of such receipt or accrual.

* * * * *

(26 U. S. C. 1946 ed., Sec. 107.)

By Section 119 of the Revenue Act of 1943, c. 63, 58 Stat. 21, the words "AND BACK PAY" were added to the title of Section 107 of the Code, and subsection (d)—containing provisions dealing with "back pay," not here material—was added to Section 107.

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.107-1. *Personal Services.*—

* * * * *

It is not necessary, in order for section 107 (a) to be applicable, that the individual who includes in his gross income compensation for such personal services be the person who renders the services. For example, a partner who shares in the compensation for such personal services rendered by the partnership may be entitled to the benefits of section 107 (a), notwithstanding that he took no part in the rendering of such services.

* * * * *

STATEMENT

The facts in these cases, which were stipulated (R. 20-25)² and were found by the Tax Court to be as stipulated (R. 49), were recited by the Tax Court in its memorandum opinion as follows (R. 49-52):

² In addition to the stipulation of facts, there were two exhibits adduced in evidence at the hearing before the Tax Court, Exhibit A, consisting of a copy of the taxpayer's income tax return for the year 1944 (R. 34-46), and Exhibit B, a copy of his wife's return for that year (R. 47 and see fn. 1, *supra*).

The taxpayer and his wife have resided in California since their marriage in 1924, to and including the taxable year 1944. Each filed a separate return for 1944 with the Collector for the first district of California. The returns were made on the cash basis. (R. 49.)

The taxpayer is a lawyer. He became associated with a law partnership in San Francisco in November 1935, as an employee of the firm; and ever since that time, he has been associated with the same firm. (R. 49.)

On May 1, 1942, the taxpayer was admitted into the partnership, and he became entitled to receive, thereafter, a distributive share, each year, of the net profits of the partnership. (R. 49.)

From the date of his employment by the firm to January 1, 1939, the taxpayer received a fixed salary as compensation for his services. Thereafter, until May 1, 1942, he received during each calendar year, in addition to a fixed salary, a fixed percentage of the net profits of the partnership, as follows: 0.463 per cent, in 1939; 0.526 per cent, in 1940; 0.631 per cent, in 1941; and 0.631 per cent, from January 1 to April 30, 1942. (R. 49-50.)

After May 1, 1942, when the taxpayer became a member of the partnership, the distributive shares of the net profits thereof to which he was entitled, and which he received, were as follows: 2.314 per cent, from May 1 to December 31, 1942; 4.573 per cent, 1943; 3.5 per cent, from January 1 to April 30, 1944; and 5.766 per cent, from May 1 to December 31, 1944. (R. 50.)

From August 4, 1935, up to and including May 1943, a period of 94 months, the partnership rendered legal services to The Equitable Life Assurance Society of the United States, hereinafter referred to as "Equitable," in connection with litigation growing out of the imposition by the State of California of a tax on gross premiums from insurance and annuities. Those services were entirely distinct and separate from other legal services then being rendered to Equitable by the partnership and after the completion of these special services, the partnership received from Equitable \$43,425 as compensation for them. That compensation was received in a lump sum in December 1944, and no other compensation was ever received by the partnership from Equitable for those services. (R. 50.)

For many years past and during all of the years material herein, all fees received for legal services by the partnership have been pooled in a single fund, which has been first used to pay all expenses. The balance, representing the net profits of the partnership, has been distributed periodically among all of the partners and all of the employees entitled to share therein. The amount of the distributions has been computed on the basis of a quarterly allocation to the profit-sharing employees, and a calendar year allocation to the partners, of the profits of the partnership, all in accordance with the percentage shares agreed upon by the partners and in effect during the period in which the net profits were received. Each partner and profit-sharing employee has shared in the division of all profits received during any period in

which he has been entitled to a share of the partnership profits according to the agreement of the partners; conversely, when a partner or employee has ceased to be such by death or retirement or otherwise, he has not shared in any profit or profits received after the month in which the cessation has occurred. (R. 50-51.)

At all times material herein, the partnership kept its books of account and filed its income tax returns on a calendar year and cash receipts and disbursements basis. (R. 51.)

Sigvald Nielson's distributive share of the partnership's net income for the year 1944 included his distributive share in the Equitable fee in the amount of \$2,504.16. One-half of that distributive share, or \$1,252.08, was the community income of Sigvald Nielson and the other one-half was the community income of his wife, Madge Nielson. (R. 51.)

In their federal income tax returns for 1944, the taxpayer and his wife each claimed the benefits of Section 107 (a) of the Internal Revenue Code and reported therein the additional income taxes attributable to their respective shares of the compensation from Equitable, had such shares been included in their gross income ratably over the preceding period of 94 months from August, 1935, to May, 1943, during which the services were rendered by the partnership. (R. 52.)

The Commissioner disallowed their claims for the benefit of Section 107 (a) of the Internal Revenue Code because the taxpayer had not been a member of the partnership for a period of 36 months, the Com-

missioner holding that, therefore, the taxpayer did not qualify for relief under the provisions of Section 107 (a). (R. 14-15, 52.)

The Tax Court, by a memorandum opinion by Judge Harron (R. 48-55), decided in favor of the taxpayer and his wife, and accordingly entered its decisions that there are no deficiencies in income tax for the year 1944 as to them (R. 55, 56).³ The present reviews followed.

STATEMENT OF POINTS TO BE URGED

On the present reviews, the Commissioner urges and relies upon all of the points originally stated and set out by him (R. 69-70) and subsequently adopted by him in this Court (R. 74) as the points upon which he intends to rely. For present purposes, they may be briefly stated as follows: (1) The Tax Court erred in holding that the taxpayer's share of the partnership fee in question is subject to tax under the provision of Section 107 of the Internal Revenue Code; and (2) the Tax Court erred in failing to uphold the Commissioner's determination that the income in question was taxable as ordinary income in the year received, without the benefit of Section 107 of the Internal Revenue Code, since the taxpayer's membership in the partnership was less than 36 months.

³ Further, since subsequent to the filing of the petitions with the Tax Court the deficiencies in question had been paid, in order to stop the running of interest, the Tax Court also found overpayments as to the taxpayer and his wife in the amount of the tax and interest respectively paid by each. (R. 24-25, 52-53, 55-56.)

ARGUMENT

The question in this case is identical to that presented in *Commissioner v. Enersen*, now pending before this Court on review as Cause No. 12,610. In deciding that case in favor of the taxpayer, the Tax Court followed, as it did in the instant case (R. 54-55), the holding of the majority of the Tax Court in *Marshall v. Commissioner*, 14 T. C. 90, now pending on review in the Third Circuit. Since in the brief filed in this Court on behalf of the Commissioner in the *Enersen* case we have already set forth our argument upon this question, including our comments upon the holding of the Tax Court majority in the *Marshall* case, we deem it unnecessary to burden the Court with a repetition here: we therefore adopt in this case and incorporate herein by reference all of the argument advanced in our brief in the *Enersen* case, and respectfully request that it be considered in this case.

The taxpayer in the *Enersen* case, as the taxpayer here, seeks the benefit of Section 107 (a) of the Internal Revenue Code with respect to his share of certain fees for long-term services received by a partnership during the taxable years at a time when he had been a member of the partnership for less than 36 months. Prior to being admitted to membership in the partnership, the taxpayer in the *Enersen* case, just as the taxpayer here, had previously been an employee of the partnership, first at a flat salary and subsequently upon the basis of a guaranteed minimum salary plus a percentage of profits. There are no material differences between the facts of this case and those of the *Enersen* case. That the record in the

Enersen case contains copies of the agreements in force during the profit-sharing period of employment, while the record in this case does not, is of no significance: the record in this case sufficiently establishes the status of the taxpayer during his profit-sharing period of employment as being that of an employee (and not a partner) who was being *currently* paid for his services. (R. 21, 49-50.)

CONCLUSION

It is submitted that the decisions of the Tax Court in these cases should be reversed, and the determinations of the Commissioner reinstated.

Respectfully submitted,

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
HARRY MARSELLI,

Special Assistants to the Attorney General.

NOVEMBER 1950.